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IN THE  
Supreme Court of the United States

October Term, 1944

KIRBY PETROLEUM COMPANY, *Petitioner*,  
v.  
COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

SUPPLEMENTAL BRIEF IN SUPPORT OF  
PETITION FOR WRIT OF CERTIORARI

HOMER L. BRUCE,  
*Attorney for Petitioner.*

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No. 1139

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May it Please the Court:

Since petitioner filed its petition for writ of certiorari in this case, the Circuit Court of Appeals for the Ninth Circuit in *Commissioner of Internal Revenue v. Anna Vickers Crawford*, No. 10,885 on the docket of that court, has affirmed on April 21, 1945, the memorandum decision of the Tax Court in that case, which may be found in Commerce Clearing House Tax Court Service, Decision No. 13,837(M). We attach a copy of the opinion of the Circuit Court of Appeals in the *Crawford* case. In that case taxpayer was the owner of certain land, just like the petitioner in this case, and executed an oil and gas lease retaining the royalty measured in part by the gross production and in part by the net profits of

the lessee. The Commissioner disallowed depletion on the taxpayer's part of the royalty measured by the net profits. Both the Tax Court and the Circuit Court of Appeals held that the taxpayer was entitled to depletion on the royalty represented by the part of the net profits, holding directly contrary to the Fifth Circuit Court of Appeals in the present case. The Circuit Court of Appeals in the *Crawford* case specifically refused to agree with the Fifth Circuit Court of Appeals in the *Kirby Petroleum Company* case.

In view of this additional conflict between the Fifth Circuit Court of Appeals and the Ninth Circuit Court of Appeals, we respectfully pray that the writ of certiorari in this case be granted.

HOMER L. BRUCE,  
*Attorney for Petitioner.*

IN THE  
**United States Circuit Court of Appeals**

For the  
**Ninth Circuit**

No. 10,885  
APRIL 21, 1945

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,  
v.  
ANNA VICKERS CRAWFORD, *Respondent*.

Upon Petition to Review a Decision of the  
Tax Court of the United States

Before: DENMAN, STEPHENS and HEALY, *Circuit Judges*. DENMAN, *Circuit Judge*:

Petitioner seeks a review of the Tax Court's order holding that the taxpayer, owner of California oil land, who has made two leases of portions thereof to the Standard Oil Company of California, the lessee to drill for and produce oil therefrom, which leases are terminable by breach of the drilling and other agreements of the lessee, is entitled to depletion deductions for the agreed royalty of a percentage of the net profits of the lessee from its sale of oil extracted from the leased land. The tax years in question are 1938, 1939, and 1940.

The Tax Court relied, in part, upon our decision in *Commissioner v. Felix Oil Co.*, F.2d 276, in which we decided that such a lessor is entitled to such deductions for the tax years 1938 and 1939 as a part of the "gross income from property" under § 114 (b) (3) of the Revenue Code. This same section is controlling for the tax year 1940.

Petitioner's brief and argument in the instant case present the same argument, based upon the same authorities, as in the *Felix* case, save that it cites the recent case of *Commissioner v. Kirby Petroleum Co.*, decided by the Fifth Circuit on March 5, 1945, Judge Hutcheson dissenting.

In that case the majority opinion states of such a payment of net profits as here reserved that it "is not the payment in kind of royalty oil or its equivalent" and contends that the net profit from the operation and sale of the oil paid to the owner of the land is not part of the gross income the land owner receives from the property. Unless the majority opinion can be distinguished on the ground that in Texas the title to the oil passes to the lessee,<sup>1</sup> whereas in California<sup>2</sup> it remains in the lessor, we are not in accord with its holding.

The Supreme Court cases relied upon in the *Kirby Petroleum* case are all based on the absence of a prop-

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<sup>1</sup>*Theisen v. Robinson*, 117 Texas 489, 510, 8 S.W.2d 646, 651; *Group No. 1 Oil Corp. v. Bass*, 283, U. S. 279, 281.

<sup>2</sup>Under California law the owner of oil land, who leases it for oil production with a royalty interest therein, retains his fee therein. The lease has a profit a prendre in the right to take the oil. If the owner transfers to another his right to collect the royalty, the owner retains the title in the land and the transferee of the royalty has an easement therein. *Callaghan v. Martin*, 3 Cal.2d 110, 123, 124.



erty interest in the oil property at the time the income from its sale is paid. In *Helvering v. O'Donnell*, 303 U. S. 370, as here, "The question is whether respondent [taxpayer] had an interest, that is, a capital investment, in the oil and gas in place." It was held that the taxpayer's prior interest was merely that of a stockholder in the corporation owning the oil land and that, as stockholder, he did not have any capital interest in the corporation's property. Hence he was not entitled to depletion on the "one-third of the net profits derived from the development and operation of the properties."

In *Helvering v. Elbe Oil Land Development Co.*, 303 U. S. 372, the taxpayer had conveyed all his interest in the oil land. Relying upon the *O'Donnell* case, the Supreme Court held that the net profits from the operation agreed to be paid *after* title had passed from the taxpayer were not subject to depletion.

In these two cases all the Supreme Court's discussion of capital interest in the oil becomes meaningless if a royalty is not subject to depletion if payable in "net profits" of the operation. Cf. dissent Judge Hutcheson in *Kirby* case.

The Kirby majority opinion does not question that if the royalty there had been a fraction of the gross cash proceeds received by the lessee from the sale of the oil taken from the land, it would be subject to depletion as "gross income from the property" to the taxpayer. Cf. *Thomas v. Perkins*, 301 U. S. 655; *Anderson v. Helvering*, 310 U. S. 404, 407, 410. We are

unable to see that it is any less "gross income" to the taxpayer from his interest in the fee in the property because the lessee deducts its costs of production before paying the taxpayer. That it is net proceeds to the lessee does not make it any the less the gross income from the land to the owner of the fee. Cf. dissent of Judge Hutcheson.

The majority opinion in the *Kirby* case seems to regard as a reason the net income from the oil is to be deemed not within the depletion provision, that it requires more calculation than the determination of the sales price of the oil produced from the taxpayer's fee. We can see no reason why the calculations necessary in all other net profit income returned during the taxable year makes the royalty paid the taxpayer any the less part of the gross income to the taxpayer from the fee owned by him. We see nothing in *Commissioner v. Kirby* or the argument here to require an overruling of our decision in *Commissioner v. Felix Oil Co.*, supra.

The order of the Tax Court is Affirmed.

(Endorsed:) Opinion. Filed April 21, 1945. PAUL P. O'BRIEN, Clerk.